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**US Disappointed with WTO FSC Ruling,  
Vows to Work With EU to Reach Solution**

United States Trade Representative Charlene Barshefsky and Secretary of the Treasury Lawrence Summers announced today that the WTO Appellate Body ruled against the United States in the dispute involving the Foreign Sales Corporation ("FSC") provisions of U.S. tax law.

"We strongly disagree with the Appellate Body's ruling," stated Ambassador Barshefsky. "Our view remains that the FSC is completely consistent with U.S. WTO obligations. We respect our WTO obligations, and will seek a solution that ensures that U.S. firms and workers are not at a competitive disadvantage with their European counterparts. It is in neither the interest of the U.S. nor the EU to allow this case to damage our bilateral relationship or to impede progress on a range of U.S.-EU activities."

"I am disappointed that the WTO Appellate Body has upheld the panel's ruling," Secretary Summers stated. "The FSC rules are widely viewed as creating a level playing field with European tax systems and are important to our business community. We will work closely with the Europeans, the business community and the Congress to achieve a constructive solution."

**Background**

The Appellate Body decision arose out of an EU complaint against the FSC provisions, which allow a portion of a U.S. taxpaying firm's foreign-source income to be exempt from U.S. income tax. Congress enacted the FSC specifically to conform to principles adopted by the GATT in 1981 and those principles were incorporated into the WTO agreements. In 1997, the EU alleged that the FSC provisions violate U.S. obligations under the WTO Subsidies and Agriculture agreements. A WTO dispute settlement panel sided with the EU last fall, and the Appellate Body has upheld the dispute settlement panel's findings.

**(More)**

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The FSC was introduced in the early 1980s after its predecessor provisions, the Domestic International Sales Corporation (DISC) rules, were found to be a prohibited export subsidy under General Agreement on Tariffs and Trade (GATT) subsidy rules. In adopting the ruling against the DISC and certain European tax provisions, the GATT Council issued an “understanding” (now also reflected in the WTO Subsidies Agreement) encompassing the following principles:

- economic processes (including transactions involving exported goods) located outside the territorial limits of the exporting country need not be subject to taxation;
- such processes should not be regarded as export activities;
- arm’s length pricing should be observed for tax purposes in transactions between exporting enterprises and related foreign buyers; and
- GATT (and now WTO) subsidy disciplines do not prohibit the adoption of measures to avoid double taxation of foreign source income.

The FSC provisions permit a portion of income generated outside the territorial limits of the United States to be exempt from U.S. income tax. To qualify for these exemptions, the FSC must have a foreign presence, meet certain management requirements and meet certain economic process requirements addressing both the extent and nature of the sales activities undertaken abroad as well as requiring that a minimum level of direct costs be incurred abroad with respect to certain sales activities (*e.g.*, advertising, order processing, etc.). If export property is sold to a FSC by a related person (or a commission is paid by a related person to a FSC with respect to export property), the taxable income of the FSC and related person is based on transfer pricing rules designed to conform to the arm’s length pricing standard in the Subsidies Agreement. (Another qualification limits the tax exemption to a portion of export income resulting from the sale of products of which at least 50 percent of the “fair market value” is attributable to domestic content.)